Daya Leasing Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

HIGH COURT (KUALA LUMPUR) — APPEAL NO R1–14–7 OF 1997
KC VOHRAH J
17 JANUARY 2000

Revenue Law *— Income tax — Assessment — Leasing companies — Separate assessment for income derived from leasing business and non-leasing business — Elements of income from leasing business comprises of principal and interest — Whether it includes the element of principal*

The appellant was in the business of providing financing which included leasing, hire purchase and factoring. Under the Income Tax (Leasing) Regulations 1986, income derived from leasing business was to be separated from income derived from non-leasing business. The gross income of the leasing business comprised of elements of principal and interest while the non-leasing business only comprised of the element of interest. There was also no formula under the regulations to calculate what proportion of common expenses incurred in a business that should be attributable to lease financing activity. The respondent resorted to a formula which the appellant disputed. The majority of the special commissioners ruled that the formula adopted by the respondent in that the income should include the element of principal and interest. The minority view rejected the appellant's formula and decided that income would only include the element of interest. The appellant appealed against the majority decision by way of case stated.

Held, allowing the appeal:

(1) Although there is no statutory provision of the method of apportioning the common expenses between two or more sources of gross income, the formula advanced by the minority view was not at cross purposes with the provisions of Income Tax Act 1967. The formula rests on an accepted principle that revenue expenditure was deductible against income revenue (see pp 444H–445A).

(2) The assessment made by the respondent was to be amended so that the formula for the apportionment of common expenses for lease financing should not take into account the element of principal and that what should be apportioned between the lease financing portfolio and non-leasing portfolio should be in accordance with the ratio between only the non-capital income from each of the two portfolios (see p 445E–F).

[Bahasa Malaysia summary

Perayu dalam perniagaan penyediaan kewangan yang termasuk pajakan, sewa beli dan faktoring. Di bawah Peraturan-Peraturan

Cukai Pendapatan (Pajakan) 1986, pendapatan yang diperolehi daripada perniagaan pajakan hendaklah diasingkan daripada pendapatan yang diperolehi daripada perniagaan bukan pajakan. Pendapatan kasar perniagaan pajakan terdiri daripada unsur-unsur prinsipal dan faedah sementara perniagaan bukan pajakan cuma terdiri daripada unsure faedah. Tiada rumusan di bawah peraturan-peraturan untuk mengira apakah pecahan perbelanjaan bersama yang ditanggung dalam satu perniagaan yang harus dianggap sebagai kegiatan kewangan pajakan. Penentang menggunakan rumusan yang dipertikaikan oleh perayu. Majoriti pesuruhjaya khas memutuskan bahawa rumusan yang diterimapakai oleh penentang dalam ertikata bahawa pendapatan harus termasuk unsur prinsipal dan faedah. Pandangan minority menolak rumusan perayu dan memutuskan bahawa pendapatan hanya akan termasuk unsur faedah. Perayu merayu terhadap keputusan majoriti melalui kes dinyatakan.

Diputuskan, membenarkan rayuan tersebut:

(1) Walaupun tiada terdapat peruntukan berkanun tentang cara membahagikan perbelanjaan bersama di antara dua atau lebih punca pendapatan kasar, rumusan yang dikemukakan oleh pandangan minoriti tidak bertentangan dengan peruntukan Akta Cukai Pendapatan 1967. Rumusan tersebut bersandar pada prinsip yang diterima bahawa perbelanjaan pendapatan boleh ditolak daripada hasil pendapatan (lihat ms 444H–445A).

(2) Penaksiran yang dibuat oleh penentang hendaklah dipinda supaya rumusan untuk pembahagian perbelanjaan bersama untuk kewangan pajakan tidak harus mengambil kira unsur prinsipal dan bahawa apa yang harus dibahagikan di antara portfolio kewangan pajakan dan portfolio bukan pajakan haruslah menurut kadar di antara pendapatan bukan modal sahaja daripada setiap dua two portfolio itu (lihat ms 445E–F).]

Notes

For cases on assessment of income tax, see 10 *Mallal's Digest* (4th Ed, 1999 Reissue) paras 1940–1958.

Cases referred to

Cape Brandy Syndicate v IRC 12 TC 358 (refd)

Edwards (Inspector of Taxes) v Bairstow & Anor [1956] AC 14 (refd)

Lower Perak Cooperative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri [1994] 2 MLJ 713 (refd)

Ostime (Inspector of Taxes) v Duple Motors Bodies Ltd [1961] 2 All ER 167 (refd)

Legislation referred to

Income Tax Act 1967 ss 5, 24(5)(a), 33(1), 36, para 13 of sch 5
Income Tax Leasing Regulations 1986 reg 3

Tay Hong Huat (*Ooi Huey Ling* with him) (*Tay & Helen Wong*) for the appellant.

Abu Tariq bin Jamaluddin (Legal Officer, Inland Revenue Dept) for the respondent.

KC Vohrah J: The appellant is in the business of providing financing for business equipment and the types of financing include leasing, hire purchase and factoring. There are common expenses incurred in running the leasing, hire purchase and factoring business. In 1986, the Income Tax (Leasing) Regulations were introduced and from the year of assessment 1986 and subsequent years, income derived from the leasing business had to be separated from income derived from the non-leasing business.

There is no specific provision in the Income Tax Act 1967 ('the Act') or the regulations made thereunder providing the formula to be used for calculating what proportion of common expenses incurred in a business of financing (which comprises lease financing activity on the one hand and non-leasing financing activities on the other) should be attributable to the lease financing activity. The respondent resorted to a formula which the appellant disputed. The appellant advanced its own formula. The majority of the Special Commissioners ruled that the formula adopted by the respondent was correct. The minority view was that neither formula was correct and opted for a different formula. Thus this case stated.

With the coming into force of the Income Tax (Leasing) Regulations 1986 ('the 1986 Regulations') made under s 36 of the Act, the gross income, for income tax purposes, of a person from lease financing 'shall be deemed as a separate and distinct business source from other activities of that person' (see reg 2).

The appellant is involved in the business of offering financing through hire purchase financing, factoring financing and lease financing. In essence the appellant carries on only one business and there are expenses incurred in the running of the business which are common to all the three types of business activities of the appellant. There is no dispute that it is not possible for the appellant to separate and calculate the exact amount for each business activity from the common expenses incurred .

Tax has to be paid on the gross income after, inter alia, allowing deductions on all outgoings and expenses wholly and exclusively incurred in the production of gross income in accordance with s 33(1) of the Act.

With the coming into force of the 1986 Regulations treating the gross income of a person from lease financing as a separate and distinct source from other activities of that person, such a person would need to know what the gross income for lease financing for the year of assessment came to and he would have to know what the outgoings and expenses were for lease financing in order to adjust the gross income for tax purposes.

Thus the problem. The expenses that are common for the running of the appellant's business of lease financing and hire purchase financing and factoring financing cannot in reality be separated. Both the appellant and the respondent, however, agree that as between lease financing as one portfolio (the leasing portfolio) and hire purchase and factoring financing as the other portfolio (the non-leasing portfolio), there should be a formula for ascertaining what proportion of the common expenses goes to the Leasing Portfolio and what to the non-leasing portfolio. For our purpose,s we need only deal with the accepted formula for the leasing portfolio:

$$\text{Common Expenses that are apportioned to Leasing Portfolio} = \frac{\text{Income from leasing portfolio}}{\text{Income from leasing portfolio + income from non-leasing portfolio}} \times \text{Common Expenses}$$

There is, however, disagreement as to what the elements which make up the income from the leasing portfolio should be.

It is not disputed that apart from some incidental income which was included in the gross income of the two portfolios, the gross income from the leasing portfolio was essentially made up of lease rentals which comprised the elements of principal and interest while the gross income from the non-leasing portfolio comprised the element of interest.

The appellant in urging its specific formula to be adopted argued that it is the element of interest earned in the leasing portfolio that constitutes the income of leasing portfolio while the respondent takes the stand for his specific formula that the elements of principal and interest make up such income.

The appellant was accordingly assessed with the respondent using his formula for computing the proportion of the common expenses which should be attributable to the leasing portfolio.

The appellant in its appeal contended before the Special Commissioners that the common expenses were erroneously apportioned by the respondent between the two portfolios in a manner not specifically provided by law. The appellant contended instead that its formula is a just and reasonable method for the apportionment.

It will be noted that both the appellant and the respondent and all the commissioners are mindful — there is no need for witnesses to come to testify to it — that neither the Act nor any regulation made thereunder has made a specific provision for calculating the proportion of common expenses which should be attributed to a leasing portfolio after the introduction of the 1986 Regulations.

The majority opinion

While the Special Commissioners agree on the general formula for calculating the proportion of common expenses attributable to the leasing

A portfolio, the majority disagree with the appellant's specific formula of only taking into account the interest element (and not the principal element) when calculating the gross income from the leasing portfolio.

The majority of the Special Commissioners first proceeded to examine what they termed 'general principles' regarding the law of taxation. They B stated that the provisions of the Act must be strictly applied in the computation of profits or gains of a person chargeable to tax and that the general scheme of the Act is that income tax is chargeable on the income earned in the relevant basis year. They went on to examine s 5 of the Act which is set out below:

> C Subject to this Act, the chargeable income of a person upon which tax is chargeable for a year of assessment shall be ascertained in the following manner:
>
> (a) first, the basis period for each of his sources for that year shall be ascertained in accordance with Chapter 2 of Part III;
>
> (b) next, his gross income from each source for the basis period for that D year shall be ascertained in accordance with Chapter 3 of that Part;
>
> (c) next, his adjusted income from each source (or, in the case of a source consisting of a business, his adjusted income or adjusted loss from the source) for the basis period for that year shall be ascertained in accordance with Chapter 4 of that Part;
>
> (d) next, his statutory income from each source for that year shall be E ascertained in accordance with Chapter 5 of that Part;
>
> (e) next, his aggregate income for that year and his total income for that year shall be ascertained in accordance with Chapter 6 of that Part; and
>
> (f) next, his chargeable income for that year shall be ascertained in accordance with Chapter 7 of that Part... F

The view was that it was clear from s 5 of the Act that the adjusted income from a business source (or any other source) is gross income less all allowable deductions permitted by the Act.

They next stated that the deduction of expenses from gross income G derived from a source is governed by the general provisions of s 33(1) of the Act which reads:

> Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the *gross income* of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by H that person in the production of gross income from that source ... (Emphasis added.)

They then observed that 'in order to arrive at adjusted income one has to deduct from the gross income all outgoings and expense wholly and exclusively incurred in the production of gross income' and 'emphasized' I that therefore the gross income is the one that matters.

They then made an inference thus: 'since s 33(1) talks about gross income it is only natural that the common expenses must be apportioned

between the leasing and the non-leasing portfolios using gross income'. They went on to say to do otherwise would be against the provisions of s 33(1) of the Act.

Turning to leasing portfolios, they pointed out that 'gross income' is clearly defined in the 1986 Regulations and that reg 3 reads:

> Gross income of a lessor
>
> The *total sum of rentals of a lease term receivable in respect of a lease* shall be deemed to accrue evenly throughout the period of such lease term and the gross income of the lessor in respect of that lease for the basis period for a year of assessment shall be a portion of the total sum receivable for the lease term, being a portion which bears the same proportion to that total sum receivable as the number of days in the basis period for that year assessment that falls within the lease term bears to the total number of days of the lease term:
>
> Provided that the *full rentals receivable in the basis period for a year of assessment may be treated as the gross income* of the lessor for the basis period for that year of assessment where the Director-General considers such treatment to be just and reasonable in the circumstances.
>
> (Emphasis added.)

They were of the view that from this, it is clear that 'gross income' of leasing portfolios comprises total rentalsis made up of principal plus interest and that on the other hand, in regard to gross income of non-leasing portfolios, it is only the interest as provided for under s 24(5)(a) of the Act which states:

> (a) The interest shall be treated as gross income of the relevant person from the business for the relevant period if the business is carried on at any time in the relevant period; and ...

They were of the view that, therefore, a different interpretation cannot be given for 'gross income' when the law clearly provides what is gross income for leasing activities and to do otherwise would be to violate the law.

They concluded that as such the respondent's method does have a legal basis ie since s 33(1) talks about 'gross income' then the apportionment of common expenses between leasing and non-leasing portfolios must be related to gross income for both and not gross income for non-leasing and 'interest income' only for leasing portfolios when the law gives a clear definition of gross income for leasing portfolios. They noted that the 1986 Regulations were introduced later (the Act came into force in 1967). They were of the view that the legislators must have had a basis for distinguishing the income of leasing activities from the income of non-leasing activities. They observed that but for reg 3 of the 1986 Regulations, only the interest element would have constituted the gross income of the leasing business and in that respect, when capital allowance is given on the asset leased, it would appear that the cost of the asset would be allowed twice. They were of the view therefore that reg 3 of the 1986 Regulations was drafted with the objective of rectifying this situation.

They rejected the method of calculation used by the appellant on the ground it has no legal basis and that it was advanced merely to serve the benefit of the appellant and in view of what Lord Guest stated in *Ostime (Inspector of Taxes) v Duple Motors Bodies Ltd* [1961] 2 All ER 167 that the taxpayer cannot decide on what principle his income is to be assessed, the appellant's method cannot be applicable.

They were of the considered opinion that the method applied by the respondent is not excessive and erroneous and is in line with the provisions of the tax laws.

The onus of proving that an assessment against which an appeal is made is excessive or erroneous shall be on the appellant (see para 13 of sch 5 to the Act). The appellant contends that the respondent's formula which the majority of the commissioners had accepted has no basis in law as it was not provided in the Act or regulations made thereunder and that reliance on s 33(1) which provides for determination of 'adjusted income' is misconceived as it provides for the determination of adjusted income from a single source by deducting from the gross income all outgoings and expenses wholly and exclusively incurred in the production of that gross income and it does not provide the manner of apportioning expenses between two or more sources of gross income.

One does not need evidence from witnesses to prove the contention. It is clear from a reading of that provision and I agree with the minority view of the Special Commissioners that the contention of the appellant that s 33(1) of the Act does not contain any provision for apportioning common expenses between more than one source of income is correct.

The majority view pointed out to the use of the expression 'gross income' in s 33(1) in the parent Act and turned to subsidiary legislation, the 1986 Regulations; reg 3 thereof, which they say defines what 'gross income' is. And that clearly cannot be correct when it has not been shown what the nexus between them is. There is no nexus.

Before that is gone into further, it is necessary to point out that the 1986 Regulations were made by the Director-General under enabling provision s 36 which reads:

> Power to direct special treatment in the computation of business income in certain cases:
>
> (1) Notwithstanding any other provision of this Part, where the Director-General is satisfied that there is a need for some treatment in computing —
>
> (a) the gross income from a business with respect to —
>
> (i) a hire-purchase transaction;
>
> (ii) a transaction under which a debt is payable by installments;
>
> (iii) *a lease transaction in respect of moveable property*; or
>
> (iv) any other transaction involving a debt or stock in trade; and
>
> (b) the *adjusted income* from the business,

he may give directions and formulate regulations to be published in the *Gazette* for special treatment with respect to any such transaction, either in relation to a particular business or in relation to any business having any such transaction:

Provided that no such directions and regulations shall have effect in relation to a business for any year of assessment with respect to which an assessment wholly or partly relating to income from that business has become final and conclusive or is the subject of an appeal which has been sent forward to the Special Commissioners.

(2) Any direction given under sub-s (1) with respect to the *gross income and adjusted income* from a business or businesses may —

(a) provide that the gross income to which it relates (or any part thereof) shall be taken to be gross income for such basis period or periods for such year or years of assessment with respect to that business or those businesses as may be specified in the direction;

(b) *provide for special treatment with respect to the ascertainment of the adjusted income* from that business or those businesses for the basis period or periods for any year or years of assessment. (Emphasis added).

Section 36 of the Act, it will be observed, makes clear reference to special treatment in computing both 'the gross income ... and the adjusted income' because it is expected that any special treatment in computing the gross income has, perforce, to provide for some special treatment in computing the adjusted income as well. In fact, it was pointed out by the minority view that sub-s (2)(b) specifically empowers the respondent to provide for special treatment with respect to the ascertainment of the adjusted income, envisaging the necessity for such special treatment to complement any special treatment in computing the corresponding gross income. However, the 1986 Regulations, while requiring the gross income from leasing transactions to be treated as being derived from a separate business source, did not at the same time also provide for corresponding special treatment in ascertaining the adjusted income, particularly the manner of apportioning common expenses to the leasing activity now that it is deemed a separate business source.

Thus there is neither a provision in the Act nor one in the 1986 Regulations (and it has not been shown there is a provision in other regulations) prescribing the manner for the apportionment of common expenses in respect of different income sources. Quite clearly, therefore, there is no legal basis for the respondent to use his method to apportion the common expenses in this case.

The majority view had relied, as pointed out, on *Ostime (Inspector of Taxes)* to say that the taxpayer cannot decide on what principle his income is to be assessed and therefore the appellant's method of calculation should be rejected. But I think what was missed is that any assessment must be done in accordance with the provisions of the Act whether the assessment is by the taxpayer or by the Inland Revenue. This was what Lord Guest said at p 176:

> It can never rest with the taxpayer to decide on what principle his income is to be assessed for tax purposes. The director's decision can never be decisive of the matter for income tax purposes. *The assessment, in addition to being consistent with normal accounting practice, must be made according to the provisions of the Income Tax Act.* (Emphasis added.)

Having said that, I must add that quite clearly and obviously the appellant's formula must also be rejected for it not having been made in accordance with the provisions of the Act.

Per the words of Rowlatt J on *Cape Brandy Syndicate v IRC* 12 TC 358 at p 366:

> Now of course it is said and urged by Sir William Finlay that in a taxing Act clear words are necessary to tax the subject. But it is often endeavoured to give to that maxim a wide and fanciful construction. It does not mean that the words are to be unduly restricted against the Crown or that there is to be any discrimination against the Crown in such Acts. It means this, I think: *it means that in taxation you have to look simply at what is clearly said. There is no room for any intendment. there is no equity about a tax; there is no presumption as to a tax: you imply nothing, but you look fairly at what is said and what is said clearly and that is the tax.* (Emphasis added.)

The conclusion is clear. There is nothing in the Act or the regulations made thereunder to authorize the use of the respondent's formula in ascertaining the adjusted income from each of the appellant's sources of income. The relevant tax assessments for the years 1987 to 1992 are erroneous to the extent that the formula of the respondent was used to determine the appellant's adjusted income.

As was stated earlier, the appellant's formula cannot also be resorted to.

What, then, should be done in the absence of a prescribed procedure? The minority view merits consideration. The view is that in the absence of any statutory procedure, the just and reasonable solution is to rely on the accepted principle that revenue expenditure is deductible only against income revenue. Since there should not be allowed any deduction of expenses against the element of principal of the lease rentals, which is capital in nature, it follows that no portion of the deductible common expenses could have been expended in the production of that part of the gross income represented by the element of principal. Thus the element of principal should not be taken into account for the purpose of apportioning the 'non-capital' common expenses, which should be apportioned between the appellant's two business portfolios according to the ratio between only the 'non-capital' income from each of the two portfolios.

This view of Special Commissioner Toong Chooi Poh is elaborated on in para 8 of the minority view where a pertinent issue was underlined — what is the crux of the dispute? The view is this:

> (8) There is no dispute over the quantum of the common expenses or the quantum of the gross income from each of the appellant's two sources for the relevant years of assessment. It is also an irrefutable fact that the appellant was effectively taxed in full on the lease rentals comprising the principal element as well as the interest element ... The dispute centred

> on the method of apportioning the common expenses. To my mind, the crux of the matter lies in the question whether any portion of the common expenses was expended in the production of that part of the gross income represented by the principal element of the lease rentals. The respondent contended that the common expenses were expended in the production of the entire gross income in the form of lease rentals, including that part represented by the principal element. On the other hand, the appellant contended that no portion of the common expenses was expended in the production of that part of the gross income represented by the principal element of the lease rentals.

The minority view then touched on the underlying rationale for the deductibility of expenses under s 33(1) thus:

> It was submitted that the underlying rationale for deductibility of expenses under s 33(1) allowed for the deduction of revenue expenditure against only revenue income and thus precluded the deduction of any portion of the common expenses against the principal element of the lease rentals which is essentially capital in nature.

The minority view then set out what one of the respondent witness had said. RW1 had testified that the Inland Revenue had recognized the assets leased out as fixed assets were due and that the same assets could be leased out to the same lessee or to any other lessee on the expiry of the lease period.

The minority view then continued,

> It is a fact that the appellant was given capital allowances in respect of the leased assets and there should therefore not also be allowed any deduction of expenses against the capital cost repayments of the leased assets which made up the principal element of the lease rentals. Since it is an agreed fact that the whole of the common expenses is deductible under s 33(1), the only logical conclusion to be drawn is that the common expenses could not have included expenditure incurred in the production of gross income represented by the principal element of the lease rentals because it is obvious that any such expenditure of a capital nature would have been expressly disallowed as a deduction by s 39(1) of the Act and therefore could not be part of the deductible common expenses. In other words, the common expenses were expended in the production of gross income represented by only the interest element of the lease rentals and incidental income in the case of the leasing portfolio, and by the interest and incidental income in the case of the non-leasing portfolio. Thus, in my considered opinion, the method of apportionment which is just and reasonable under the circumstances is neither the respondent's method nor the appellant's method, but instead should be based on the ratio between: (i) the 'non-capital' income from the leasing portfolio represented by the interest element of the lease rentals plus the incidental income, in relation to (ii) the 'non-capital' income from the non-leasing portfolio represented by the interest income plus the incidental income.

Although there is no statutory provision for the method of apportioning the common expenses between two or more sources of gross income, the formula advanced by the minority view is not at cross-purposes with provisions of the Act. A tax has to be collected and although there is no express provision how it should be calculated, one has to go back to first

principles. The formula rests on an accepted principle that revenue expenditure is deductible against income revenue. It is also a just and reasonable solution to a problem which has not been addressed by the respondent under powers which he has under s 36 of the Act. In contrast it has not been shown that either the respondent's or the appellant's formula is in accordance with accepted principles of taxation.

The functions and powers of the court with regard to tax appeal cases were laid out in the case of *Lower Perak Cooperative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 where the court adopted the principles in the case of *Edwards (Inspector of Taxes) v Bairstow & Harrison* [1956] AC 14:

> If the case contains anything ex facie which is bad law and which bears upon the determination, it is, obviously, erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that this has been responsible for the determination. So there, too, there has been error in point of law. I do not think that it much matters whether this state of affairs is described as one in which there is no evidence to support the determination or as one in which the evidence is inconsistent with and contradictory of the determination, or as one in which the true and only reasonable conclusion contradicts the determination.

I am satisfied the majority view on the matter is erroneous on a point of law.

I allow the appeal. The assessments made by the respondent for the years of assessment 1987 to 1992 are amended so that the formula for the apportionment of the common expenses for lease financing shall not take into account the element of principal and that what should be apportioned between lease financing portfolio and non-leasing portfolio shall be in accordance with the ratio between only the non-capital income from each of the two portfolios. Half costs to the appellant.

Appeal allowed.

Reported by Andrew Christopher Simon